YOLO
LOCAL
AGENCY
FORMATION
COMMISSION

January 2, 2019

Kyle Lang, General Manager
Reclamation District 537
PO Box 822
West Sacramento, CA 95691

Kenric Jameson, General Manager
Reclamation District 900
PO Box 673
West Sacramento, CA 95691

Aaron Laurel, City Manager
City of West Sacramento
1110 West Capitol Avenue, 3rd Floor
West Sacramento, CA 95691

RE: Request for Legal Opinion re: LAFCo Proposal Nos. 925, 926 & 930

Dear Mr. Lang, Mr. Jameson and Mr. Laurel:

In evaluating the proposals submitted by the City of West Sacramento, RD 537, and RD 900, I have identified two legal issues that may be relevant to the Commission's determination:

1) What are the legal implications to WSAFCA under the following scenarios:
   a. RD 900 and RD 537 become subsidiary districts to the City (LAFCo Proposal Nos. 925 and 926); and
   b. RD 900 annexes the RD 537 territory south of the Sacramento Weir, resulting in RD 537 existing solely outside the West Sacramento Basin Levee System (LAFCo Proposal No. 930)?
2) How would creation of RD 900 and RD 537 as subsidiary districts to the City affect the City's exposure to liability in the event of a flood event (LAFCo Proposal Nos. 925 and 926)?

I understand that the parties may have different views on these issues, and LAFCo staff could benefit from the parties' input. I therefore invite the parties to each submit written letter briefs to me by February 28, 2019, discussing the legal implication of these two issues. I do not intend this to be an extensive undertaking, and ask that each party wishing to participate limit its submission to 10 pages or fewer. The submission is completely voluntarily, and no party will be penalized if it elects not to respond to this request. Please note that anything submitted will be part of the public record.

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Please feel free to contact me, or Eric May (Commission Counsel, 530-666-8278) if you have any questions.

Sincerely,

Christine M. Crawford, AICP
Executive Officer

KRONICK
MOSKOVITZ TIEDEMANN & GIRARD

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Sacramento, CA 95814

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MEMORANDUM

TO: Aaron Laurel, City Manager

FROM: Jeffrey Mitchell, City Attorney

CC: Charline Hamilton

DATE: February 25, 2019

RE: RD 537 and 900 Reorganization

The Yolo County LAFCO has undertaken an examination of various local government service providers including Reclamation Districts 537 and 900 located, in part, within the City of West Sacramento's boundaries. As a part of this analysis, LAFCO is considering two reorganization proposals. One proposal involves the two RDs becoming subsidiary districts of the City. A second proposal involves RD 900 annexing the RD 537 territory south of the Sacramento Weir with the remainder of RD 537 existing solely outside of the West Sacramento Basin Levee System. Under this second proposal, the City would assume control of all internal drainage operations. LAFCO has posed the following two questions, and asked interested parties for their input:

1. What are the legal implications to WSAFCA under the following scenarios:

    a. RD 900 and RD 537 become subsidiary districts to the City; and

    b. RD 900 annexes the RD 537 territory south of the Sacramento Weir, resulting in RD 537 existing solely outside the West Sacramento Basin Levee System?

2. How would creation of RD 900 and RD 537 as subsidiary districts to the City affect the City's exposure to liability in the event of a flood event?

The following legal analysis is provided and may be shared with LAFCO and all interested parties.

1. Legal Implication to WSAFCA.

WSAFCA is a joint powers agency formed by the Joint Exercise of Powers Agreement dated July 20, 1994, between the City, RD 900 and RD 537, as amended on October 13, 2011 ("WSAFCA Agreement"). The Joint Exercise of Powers Act (Government Code sections 6500-6599.3) ("JPA Act") authorizes parties to a joint exercise of powers agreement to establish an agency or entity that is separate from the parties. (*See*, *e.g.*, Gov. Code § 6503.5.)

Accordingly, Section 2 of the WSAFCA Agreement states: “The Agency shall be a public entity separate from the Parties hereto.” Sections 18 and 19 provide that WSAFCA shall undertake planning, developing, designing, acquiring, funding and constructing flood control works and facilities. Section 22 allows WSAFCA to levy assessments for operation and maintenance and "for the satisfaction of liabilities imposed against the Agency arising from said Project." Section 25 also allows WSAFCA to issue bonds. In addressing liabilities, Section 29 provides that "[t]he debts, liabilities and obligations of the Agency shall be the debts, liabilities or obligations of the Agency alone and not of the Parties to this Agreement." Thus, the WSAFCA Agreement contemplates that WSAFCA will engage in project activities, raise the necessary funds and be responsible for liabilities related to its actions. The proposed reorganization would not alter any of these rights or responsibilities of WSAFCA.

In regards to WSAFCA's continued existence, Government Code section 6510 provides that: "The agreement may be continued for a definite term or until rescinded or terminated. The agreement may provide for the method by which it may rescinded or terminated by any party." In terms of such termination, Section 31 of the WSAFCA Agreement provides that: “The Agency shall continue until this Agreement is rescinded or terminated as herein provided.” Section 32 of the WSAFCA Agreement further provides for termination upon unanimous consent of the parties.

The proposed reorganization would not result in rescission or termination of the WSAFCA Agreement since all parties, or at least two parties, to the agreement would remain in existence. To the extent RD 537 would no longer be a party to the Agreement, Section 34 provides that a party may withdraw from the "agency" with the unanimous written consent of all parties. Section 34 does not provide that the agreement terminates upon withdrawal of a party. In fact, it makes provision regarding actions by the Agency following a withdrawal, e.g.: "The Agency may not sell, lease, transfer or use any rights of a Party who has withdrawn without first obtaining the written consent of the withdrawing member."

Additionally, as to assignments, Section 36 provides: "Except as otherwise provided in this Agreement, the rights and duties of the Parties may not be assigned or delegated without the written consent of all other Parties. Any attempt to assign or delegate such rights or duties in contravention of this Agreement shall be null and void. Any approved assignment or delegation shall be consistent with the terms of any contracts, resolutions, indemnities and other obligations of the Agency then in effect." This assignment clause, and any related restrictions, would not be applicable if the RDs remained as subsidiary districts since they would not be assigning any rights as a result of the reorganization. Any rights and obligations of the RDs under the Agreement would remain the same. The City and RDs will continue to function as participating members of the WSAFCA JPA in the same manner in which they have participated since the establishment of the JPA. (*See* Gov. Code § 57534 [on and after being established as a subsidiary district, "[t]he district shall continue in existence with all of the powers, rights, duties, obligations, and functions provided for by the principal act . . . ."].)

However, consents would be required if RD 537 were to withdraw from the agreement and any of its rights and obligations assigned to other members. This is consistent with sections 34 and 36 of the Agreement as noted above. Additionally, a 2011 Amendment to the Agreement recites that:

E. The CVFPB has adopted policy resolution, Resolution 09-17, under which the CVFPB will accept indemnification of OMRR&R from a Joint Powers Agency which is a local sponsor for a flood control improvement project requiring a permit from the CVFPB, without requiring indemnification for OMRR&R from each and all of its member agencies if, (i) the JPA provides that it will not be dissolved so long as the Joint Powers Agency has made outstanding commitments to the CVFPB for OMRR&R and OMRR&R indemnification, or (ii) the member agencies of the Joint Powers Agency will provide the foregoing maintenance assurances and indemnification prior to the Joint Powers Agency dissolving, or (iii) the Joint Powers Agency provides to the CVFPB such other agreements or assurances as may be acceptable to the CVFPB.

F. The purpose of this Amendment to the JPA is to comply with the CVFPB policy resolution referenced in recital E, above, so as to not require indemnification for OMRR&R by all of the Member of the WSAFCA.

The amendment then adopted the required terms restricting termination of the Agreement or withdrawal by a party unless the member parties provide assurances to the CVFPB. Section 39, as contained with the 2011 amendment, prohibits withdrawal of a Member from WSAFCA if there are outstanding Project Commitments "unless such withdrawing party first provides such written assurances regarding the Project Commitments as the CVFPB may request." As noted, the reorganization will not result in the termination of the Agreement nor will it result in any party withdrawing from the JPA if the RDs were to become subsidiary districts. However, the extent RD 537 withdraws from the Agreement, it would be necessary to determine what assurances, if any, the CVFPB would require and whether such conditions would be acceptable to the City and RD 900 as the remaining parties to the Agreement.

2. Implications To City's Liability After Creation Of Subsidiary Districts.

Under the City's proposal, the RDs would not merge with and be subsumed by the City. Instead, they would retain independent existence as subsidiary agencies. The only change would be that the City Council would constitute the RDs governing board rather than having an independently elected or appointed board. The Cortese-Knox-Hertzburg Local Government Reorganization Act of 2000, contemplates this type of reorganization and provides for the "establishment of a subsidiary district" as an alternative to a merger. (Gov. Code § 56021.) A "'subsidiary district' means a district in which a city council is designated as, and empowered to act as, the ex officio board of directors of the district." (Gov. Code § 56078.) Specifically as to such subsidiary districts, it provides that: "[o]n and after the effective date of an order establishing a district as a subsidiary district of a city, the city council shall be designated, and empowered to act, ex officio, as the board of directors of the district. The district shall continue in existence with all of the powers, rights, duties, obligations, and functions provided for by the principal act, except for any provisions relating to the selection or removal of the members of the board of directions of the district." (Gov. Code § 57534, emphasis added.)

The fact that the City Council would also serve as the governing board for the subsidiary RD would not provide a basis for imposition of liability on the City. As one court confirmed, "[w]ell-established and well-recognized case law holds that the mere fact that the same body of officers acts as the legislative body of two different governmental entities does *not* mean that the two

different governmental entities are, in actuality, one and the same." (*Macy v. City of Fontana* (2016) 244 Cal.App.4th 1421, 1429.) Thus, even though two entities may have the same governing body, the statutory duties of one cannot be ascribed to the other. (*Id.* at 1430.) Similarly, another case rejected the argument that "if the same legislative body acts in two different governmental capacities, representing two different government entities, there must still necessarily be only one legislative body, and consequently, only one (for all intents and purposes) governmental entity." (*Pacific States Enterprises, Inc. v. City of Coachella* (1993) 13 Cal.App.4th 1414, 1424.) As described in another case, the fact that the Los Angeles County Board of Supervisors also served as the governing board of the Los Angeles County Flood Control District was "a mere fortuitous circumstance" and action by the Board of Supervisors, taken when acting as directors of the Flood Control District, is not action taken by or on behalf of the County. (*County of Los Angeles v. Continental Corporation* (1952) 113 Cal.App.2d 207, 219-220.) Thus, these cases support the argument that the City would not be liable for any action or inaction of the RD even if the City Council was also the governing board for the RD unless an independent basis existed for holding the City liable.[1]

3. Implications To City's Liability of the RD's Proposed Reorganization.

To the extent that the RD's proposal would involve having the City take over internal drainage functions currently supported by RD 900 and 537, the City's cost and liability could potentially increase. Under this proposal, RD 900 would convey to the City all of RD 900's interest in land, whether acquired by grant, dedication, condemnation, or prescriptive use for ditches canals, detention basins, and pumping plants, together with all pumps, motors, switching gear, and ancillary equipment reasonably necessary or useful to operate the pumping plant related to internal drainage within the boundaries of the City. RD 900 and 537 contend that there should be no cost to the City to operate the drainage facilities, and no increased cost to the landowners. The costs would be covered by RD 900's Benefit Assessment Act of 1982 assessment, which would be passed to the City to levy and collect pursuant to Government Code section 56886(u) as a condition of this change in organization, and a portion of the RD 537 existing assessment. The City has not analyzed whether these assessments are adequate for the maintenance and operation of the internal drainage functions the City would assume under RD's proposal. However, assuming that the RD's assertions are correct, there should be no uncovered cost for the City to operate such drainage facilities.

As to potential liability, to the extent that the City takes on a larger role in the operation, control or maintenance of drainage facilities, the City may potentially incur increased liability if the facilities under the City's operation and control were to fail. (*See Arreola v. County of Monterey* (2002) 99 Cal.App.4th 722, 761.) However, such liability cannot be automatically assumed under any circumstance, and any liability would require a detailed analysis of the causes of any

[1] Notwithstanding these cases, there are some older cases which have found one agency liable for the acts of another agency when they have common governing boards. (*See Oceanside Marina Towers v. Oceanside Community Development Commission* (1986) 187 Cal.App.3d 735; *Nolan v. Redevelopment Agency* (1981) 117 Cal.App.3d 494.) These cases have been soundly criticized and not followed by more recent decisions. Accordingly, we believe a strong argument exists that the City would not incur liability solely based upon the fact that the City Council was also the governing board of the RD, a subsidiary district, and this argument would be supported by recent court decisions.

failure and the role played by the City or any other potentially responsible party. For example, simply engaging in routine maintenance or opting not to upgrade facilities may not provide a basis for increased liability. (*See Paterno v. State of California* (2003) 113 Cal.App.4th 998.) Any liability for either the City or RDs would require an examination of what activities they have previously undertaken, what agreements they have previously entered into, and the terms under which the transfer of facilities to the City occurred. This liability would not necessarily change simply based upon the reorganization.

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James M. Day, Jr.
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February 28, 2019

COPY VIA EMAIL
ORIGINAL VIA U.S. MAIL

Christine M. Crawford
Executive Officer
Yolo Local Agency Formation Commission
625 Court Street, Suite 107
Woodland, CA 95695

Re: *Yolo LAFCO Request for Analysis of Legal Implications to WSAFCA Arising From RD 900 Proposal and Arising From City of West Sacramento Proposal, and Liability Exposure to City Arising from City of West Sacramento Proposal*

Dear Ms. Crawford:

You have asked for an analysis of two legal issues with reference to LAFCO Proposal Numbers 925, 926 & 930. First, what are the legal implications to WSAFCA under:

a. The City of West Sacramento's proposal that RD 900 and RD 537 become subsidiary Districts to the City (LAFCO Proposal Numbers 925 and 926 – hereinafter the "City Proposal"); and

b. RD 900's proposal that the RD 537 territory south of the Sacramento Bypass be detached from RD 537 and annexed into RD 900 (LAFCO Proposal Number 930 – hereinafter the "RD 900 Proposal").

Secondly, how creation of RD 900 and RD 537 as subsidiary Districts to the City affects the City's exposure to liability in the event of a flood event. I will address the first issue here. Downey Brand, LLP, which is counsel for RD 537, has addressed the second issue regarding City exposure to liability in the Memorandum attached hereto.

Implications to WSAFCA.

From a purely technical legal standpoint, under both the WSAFCA Joint Exercise of Powers Agreement and under the Joint Exercise of Powers Act set forth in California Government Code Sections 6500 et seq., WSAFCA may continue to function as currently constituted under either the City Proposal or the RD 900 Proposal.

Under the City Proposal RDs 537 and 900 continue to exist as legal entities (and as parties to the WSAFCA Joint Exercise of Powers Agreement) with the governing Reclamation District Boards of Trustees being replaced by the City of West Sacramento City Council. Under the RD 900 Proposal, nothing contained in the WSAFCA Joint Exercise of Powers Agreement (the "JPA Agreement") or in the Joint Exercise of Powers Act will prohibit a party, in this case RD 537, from being a party even though it no longer would have levee and flood control operation and maintenance responsibilities within the WSAFCA boundaries. In fact, the Joint Exercise of Powers Act provides in Government Code Section 6502 that, "it shall not be necessary that any power common to the contracting parties be exercisable by each such contracting party with respect to the geographical area in which such power is to be jointly exercised." That section even specifically allows for one or more of the contracting parties to be located outside this state.

Notwithstanding the foregoing, under both the City Proposal and the RD 900 Proposal the practical implications for WSAFCA would be something different than the parties bargained for when WSAFCA was formed by execution of the JPA Agreement dated July 20, 1994.

In the case of the City Proposal, WSAFCA effectively becomes governed by only one of the three members, with the City Council of the City of West Sacramento appointing each of the three board members. Under the City Proposal, the reclamation districts exist largely in name only with the City Council acting as the governing board for both of them. There would no longer be the checks and balances of having three board members, each appointed by a separate and independent governing board. The selection of consultants, the approval of design, the adoption of budgets, and the use of WSAFCA agency funds would all be within the discretion and control of the City of West Sacramento. The exercise of veto powers as provided in Section 16 of the JPA Agreement, under which, "any Party may exercise a veto with respect to either: (a) the construction and/or acquisition of Works or Facilities or (b) the imposition that any assessment, fee, or charge to be levied for any Projects, Facilities, or Works authorized pursuant to this Agreement.", and the manner of exercising that veto by requiring a certified resolution of the governing body of the party that's seeking to exercise the veto would be rendered essentially meaningless.

Under the RD 900 Proposal, RD 537 would remain a party to WSAFCA, appointing one of the three WSAFCA board members, even though RD 537 would not have levee or flood control operation and maintenance responsibilities within WSAFCA's boundary, and would have veto power under Section 17 of the JPA Agreement.

The key distinction between the practical effects of the City Proposal and of the RD 900 Proposal is that under the RD 900 Proposal there is a method by which RD 537 can withdraw from WSAFCA, and, if the Parties so desire and can agree, representation of the governing board of WSAFCA can be modified by amendment to the JPA Agreement. For RD 537 to withdraw from WSAFCA all of the current Parties (the City, RD 900 and RD 537) would need to unanimously consent to that withdrawal (JPA Agreement Section 34(a)). Additionally, under Section 39 of the JPA Agreement, which was added by Amendment dated October 13, 2011 at

the request of the California Central Valley Flood Protection Board, so long as there are outstanding project commitments to the State (in this case funding agreements and the so called "OMRR&R" agreements which will stay in place indefinitely) reasonable written assurances must be provided regarding the Project Commitments and accepted by the Central Valley Flood Protection Board. In all likelihood, with the RD 537 urban area property within the City of West Sacramento and assessments against it remaining within WSAFCA boundaries and now administered by RD 900, consent of the Central Valley Flood Protection Board is likely achievable.

With completion of the withdrawal of RD 537 from WSAFCA, WSAFCA could either continue to operate with a two person governing board, which will require that any required approvals be accomplished by consensus (to date I believe every action taken by the WSAFCA Board has been by consensus) or the Parties could agree to amend the JPA Agreement in any manner they could agree upon to add one or more governing board members. For example, a third public board member required to be a resident within the City of West Sacramento and acceptable by both the City and the RD 900 appointed board members could be appointed.

Yours very truly,

DAY CARTER & MURPHY LLP

James M. Day, Jr.

JMD:tl
Attachment: Downey Brand, LLP Memorandum to RD 537 dated February 25, 2019
cc: Kenric Jameson (via email and U.S. Mail)
Kyle Lang (via U.S. Mail)
Aaron Laurel (via U.S. Mail)
Dan Ramos (via email)

DOWNEY | BRAND
ATTORNEYS LLP

MEMORANDUM

To: RECLAMATION DISTRICT 537 FOR PUBLIC DISTRIBUTION

From: SCOTT SHAPIRO
BRIAN HAMILTON

Date: FEBRUARY 25, 2019

Re: **ANALYSIS OF THE CITY OF WEST SACRAMENTO'S POTENTIAL LIABILITY FOR SUBSIDIARY CONSOLIDATED RECLAMATION DISTRICTS**

Climat: 00716.00000

This memorandum analyzes the potential liability to the City of West Sacramento (the "City") for inverse condemnation claims if Reclamation District ("RD") 900 and RD 537 become subsidiary districts of the City. This analysis expands on a previous memorandum from Scott Shapiro to the Board of Trustees for RD 537, dated February 18, 2018, and relies on that memorandum's background explanation of inverse condemnation liability. That memorandum was shared with other local agencies and the Yolo County Local Agency Formation Commission to assist the local community and decisionmakers with the policy issues raised by different forms of agency consolidation. The focus on this memorandum is on the City's liability for inverse condemnation if RD 900 and the portion of RD 537 south of the Sacramento Bypass (collectively referred to as the "RDs") become a subsidiary of the City. As with the 2018 memorandum, this memorandum is also intended to be shared publicly to assist in evaluating different policy options. The conclusion of this memorandum is that although the alter ego doctrine may not apply, the City may be primarily liable for inverse condemnation in certain circumstances.

FACTUAL BACKGROUND

The City seeks to make the RDs subsidiary districts of the City. The City has initiated the process pursuant to the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000, (Gov. Code, § 56000, *et seq.*). A subsidiary district is a district of limited powers in which a city council is designated as, and is empowered to act as, the ex officio board of directors of the district. (*Id.*, § 56708.) But the district is still treated as a separate legal entity. (*Id.*, § 57534.)

The City Attorney stated in an interview with the Sacramento Bee his belief that making RDs subsidiaries of the City would not raise liability concerns:

> City Attorney Jeff Mitchell said he's examined the issue and does not believe "that the mere fact that the City Council becomes the governing board exposes the city of West Sacramento to liability in the event of a levee breach."

> Mitchell declined to provide documentation or analysis, citing attorney-client privilege.

Kellen Browning, *Could West Sacramento Be Forced to Pay Up if the River Floods? Mayor and Residents Disagree*, Sacramento Bee (June 18, 2018).

The City's staff analysis echoes this position: "the reorganization would not result in increased inverse condemnation liability unless the City entered into new obligations or increased its own role in project related activities after the reorganization." (City of West Sacramento Agenda Report (May 23, 2018) ("City Agenda Report"), p. 3.)

LEGAL ANALYSIS

A. The Application of the Alter Ego Doctrine to Government Agencies

In the corporate context, the alter ego doctrine allows courts to set aside the legal fiction of corporate separateness to impose liability on the corporation's shareholders (i.e., "piercing the corporate veil"). (*Santa Clarita Organization for Planning & Environment v. Castaic Lake Water Agency* (2016) 1 Cal.app.4th 1084, 1104 (*Santa Clarita*).) The same doctrine is applied to hold parent corporations liable for the conduct of subsidiaries. (*Ibid.*)

For the following reasons, it is unlikely that a court would apply a theory of vicarious liability or some form of "piercing the corporate" veil in this context. Instead, the City is unlikely to be liable for the conduct of the consolidated subsidiary district absent facts supporting direct liability, which is discussed at length in the next section.

At least one case has applied the alter ego doctrine to government entities. In *Tucker Land Co. v. State of California* (2001) 94 Cal.App.4th 1191 (*Tucker*), the Court of Appeal upheld the trial court's determination on summary judgment that the member agencies of a JPA were not liable for the torts of the JPA. (*Id.* at p. 1201.) Government Code section 6508.1 provides that a JPA's constituent members are liable for the debts of the JPA absent an agreement otherwise. In *Tucker*, however, such an agreement existed. (*Id.*, at pp. 1200–1201.) So the plaintiff instead argued that the JPA was liable under the alter ego doctrine. The court noted that "it is not clear whether the trial court refused to impose liability on the alter ego theory because it found alter ego never applies to governmental entities, or because the facts did not support its imposition." (*Ibid.*) Despite noting this, the court also did not answer this question of whether government agencies *can* be liable under the alter ego doctrine; instead, it simply determined that the evidence in the record did not support liability on such a theory. (*Id.* at pp. 1201–1202.)

In *Rider v. County of San Diego* (1991) 1 Cal.4th 1, 12–13 (*County*), the court applied a doctrine analogous to the alter ego doctrine to determine whether one government agency essentially controlled another. In that case the issue was whether a finance authority had been created by the county in order to levy a sales tax in a manner that circumvented Proposition 13. Sufficient evidence had been produced showing the county's intention to circumvent Proposition 13, but

the court noted that in other circumstances, such intent would have to be inferred. It set forth a multi-factor test to determine whether the tax agency was essentially controlled by the county or city that created it. (*Id.* at p. 12.) The court also cited favorably *Vanoni v. County of Sonoma* (1974) 40 Cal.App.3d 743 (*Vanoni*), wherein taxpayers argued that the Sonoma County Flood Control and Water Conservation District was simply an alter ego of the county created in an effort to avoid the state's constitutional debt limitations. (*Id.* at pp. 748–749; Cal. Const., art. XVI, section 18, cited as former Cal. Const., art. XIII, Section 40 (repealed and replaced, 1974).) The district and the county shared the same boundaries, citizens, and taxable property. The members of the county's board of supervisors were the ex officio members of the district's governing board. The court found this evidence was not sufficient to establish that the county *actually* controls the district and thus held that the district was a separate legal entity. (*Vanoni, supra*, at pp. 750–751.)

The court in *County* agreed with this conclusion, but noted that although board control "does not invariably indicate" essential control, it is relevant to the question. (*County*, *supra*, at p. 12.) The court noted, however, that the essential control test was only relevant to determining whether an entity was attempting to circumvent Proposition 13. (*Ibid.*) The court expressly stated that the purpose of the test was not to "demonstrate that the subject agency and county are *identical* entities." (*Ibid.*)

In 1998, the California Supreme Court faced similar questions in *Rider v. City of San Diego* (1998) 18 Cal.4th 1035 (*City*). The question before the court was whether a joint powers authority was created for the purpose of avoiding the constitutional debt limitation. (*Id.* at p. 1041.) The court cited *County* but noted that the essential control test did not apply to the plaintiffs' argument that the city and the joint powers authority were identical entities. (*Id.* at p. 1044.) For one, *City*'s essential control test was only limited to the context of Proposition 13. (*Ibid.*) For another, the statute authorizing the creation of such joint powers authorities provides that such authorities have a "genuine separate legal existence from the City." (*Ibid.*, citing Gov. Code, § 6503.5.)

San Diegans for Open Government v. City of San Diego (2015) 242 Cal.App.4th 416 (*San Diegans*) reached a similar result. The Court of Appeal addressed whether a financing authority created to issue bonds had a separate corporate existence from the city. (*Id.* at pp. 437–438.) The court determined that the statutory language establishing the financing authority stated that it was a separate legal entity. (*Id.* at p. 438, citing Gov. Code, §§ 6503.5, 6507, 6551.) "[Plaintiff] asks us to ignore the separate legal status of the entities, but we may not do so." (*San Diegans*, *supra*, at p. 438; citing *City of Cerritos v. Cerritos Taxpayer's Assn.* (2010) 183 Cal.App.4th 1417, 1442 (noting that the "it does not matter whether or not the city essentially controls" the agency where there is a "genuine separate existence" between the city and agency).)

The source of this refusal to treat the agencies as identical lay primarily in the express statutory provisions conferring the separate status of each agency. (See *San Diegans*, *supra*, at p. 438.) Applied here, Government Code section 57534 provides that a subsidiary district is a separate

legal entity from its parent: "The district shall continue in existence with all of the powers, rights, duties, obligations, and functions provided for by the principal act . . . ." Section 57534 brings the status of subsidiary districts closer in line with the cases where courts held that the statute providing for the separate existence of the agency meant that the alter ego doctrine categorically did not apply, such as *City* and *San Diegans*.

It is unlikely that a court would apply the alter ego doctrine to the present circumstances given that the statutory framework allowing the creation of the type of subsidiary district in question appears to treat such a subsidiary as a separate legal entity. (Gov. Code, § 57534.) Nevertheless, no court has addressed this question, so the matter is not settled.

Although the case law demonstrates a number of courts applying the alter ego doctrine to government entities, research on this subject revealed no case where a court actually concluded that one government agency was the alter ego of another. However, none of the cases cited above indicated that the alter ego doctrine could not be applied in the context of government entities. Instead, courts either determined that the facts did not support application of the alter ego doctrine (see, e.g., *Vanoni*, *supra*, 40 Cal.App.3d at pp. 750–751) or that the separateness of certain entities was determined by statute, so the application of the alter ego doctrine to the facts of the case had no bearing on the question. (See, e.g., *San Diegans*, *supra*, 42 Cal.App.4th at p. 438.)

As discussed in much greater detail in the following section, courts in other contexts have been willing to hold superior agencies primarily liable for the failure of subsidiary flood control districts as a matter of public policy. Addressing dangerous conditions at a railroad crossing, the California Supreme Court refused to allow a city to "complacently declare that they were powerless over a long period of years to take any reasonable steps to remedy a defective and dangerous condition that existed in one of the principal streets of the city." (*Shea v. City of San Bernardino* (1936) 7 Cal.2d 688, 693.) In the context of flood control, such public policy concern with allowing a local government to avoid taking responsibility for critical infrastructure nominally controlled by a subsidiary agency "applies with even greater force where the risk threatens an injury such as that which occurred here." (*Arreola v. County of Monterey* (2002) 99 Cal.App.4th 722, 765.)

Of course, such public policy concerns would weigh heavily in an alter ego analysis. Courts apply the alter ego doctrine where "(1) there 'is such unity of interest and ownership that the separate personalities of the [subsidiary] corporation and [its parent corporation or individual owners] no longer exist' and (2) 'if the acts are treated as those of the [subsidiary] alone, an inequitable result will follow.'" (*Santa Clarita*, *supra*, 1 Cal.app.4th 1084,1105, citing *Mesler v. Bragg Management Co.* (1985) 39 Cal.3d 290, 300, insertions in original.) This requires looking at the totality of the circumstances related to the relationship of the parent and subsidiary. (*Santa Clarita*, *supra*, at p. 1105.) This includes (1) whether the two entities comingled funds and assets, (2) whether the parent represented to third parties that it is liable for the subsidiary's debts, (3) whether the parent owns 100 percent of the subsidiary's stock, (4) whether the entities share the same offices and employees, (5) whether the subsidiary is used as a mere shell or

conduit of the original entity, (6) whether the subsidiary is adequately capitalized, (7) whether the entities ignore corporate formalities such as holding board meetings, maintaining corporate records, and acting on votes of the respective boards, (8) whether the parent and subsidiary commingle corporate records, (9) whether entities have identical directors and officers, and (10) whether the parent has diverted the subsidiary's assets to the parent's uses. (*Id.* at pp. 1105–1106.)

Applying those factors here is difficult to the extent that this is only a prospective acquisition. Thus, we are missing many of the facts necessary to fully address these factors. Some factors would militate against applying alter ego. It appears likely that existing assessments and funding streams received by the RDs would remain with the RDs if they become subsidiaries. (Yolo LAFCo Staff Report, p. 7.) Although such separate funds favor the City in this analysis, it remains to be seen whether a consolidated district would be adequately capitalized. Of course, if the City does not adequately capitalize its subsidiary district, primary liability as described below would also likely apply. Nor is it apparent yet whether the City will properly observe corporate formalities or commingle records.

Certain facts, however, already indicate a lack of separateness. For one, the City Council's members would constitute the ex officio board of the RDs and the City intends to replace the administrative and management staff of RD 537 with employees from RD 900. (City Financial Analysis, p. 2.) It seems that a principal reason that the City would make the RDs subsidiaries instead of simply merging the RDs into the City is for the liability protection afforded by treating the RDs as subsidiaries. (See Yolo LAFCo Staff Report, p. 8.) The concern here is that such an attempt to avoid liability for such a serious threat to life and property is exactly the type of complacency that courts have been unwilling to tolerate in other instances. (See *Shea*, *supra*, 7 Cal.2d at p. 693; *Arreola*, *supra*, 99 Cal.App.4th at p. 765.) Such efforts to reap the benefits of a merger without taking the attendant responsibility for the public welfare would also constitute the sort of inequitable result that would militate in favor of applying the alter ego doctrine. Nonetheless, a court applying the alter ego doctrine remains unlikely in light of the explicit statutory language indicating the separate legal status of the subsidiary district.

B. Even Without the Alter Ego Doctrine, the City Would Still Be Primarily Liable in Certain Circumstances

The City's position is that making the RDs into a subsidiary district would not expose the City to liability for inverse condemnation merely by virtue of having shared boards. Even if the alter ego doctrine does not apply, the City's position likely misstates the reality of their potential liability. In 2002, the Sixth District Court of Appeal faced this very issue. *Arreola v. County of Monterey* (2002) 99 Cal.App.4th 722 (*Arreola*), was an appeal from a suit by about 300 property owners against the state, four counties, and two other public agencies, including the County of Monterey (the "County") and the Monterey County Water Resources Agency ("MCWRA"). (*Id.* at p. 730.) The government defendants were found liable for tort damages and inverse condemnation resulting from flooding caused by the failure of levees on the Pajaro River in 1995. (*Ibid.*) Relevant here, MCWRA was a subsidiary agency of the County, and the County

argued that it should not be liable for the levee failure since MCWRA was the relevant authority and the County was a separate legal entity. The court held that the County was directly liable for inverse condemnation resulting from the County's inadequate maintenance because of the County's knowledge of ongoing maintenance problems with the levee, its financial control of MCWRA, its failure to act, and the vital public interest at stake.

Because of the factual similarities to the current case and the importance of those facts to the court's analysis, this memorandum will undertake a lengthy exploration of *Arreola*. The levees that failed were part of the Pajaro River Levee Project (the "Project"), which was constructed by the U.S. Army Corps of Engineers ("USACE") pursuant to the Flood Control Act of 1944 (Public Law No. 534, ch. 655 (Dec. 22, 1944), 58 Stat. 887). (*Arreola, supra*, at p. 731.) Construction of the project was conditioned on the agreement of local government agencies to operate and maintain the Project in accordance with USACE standards. (*Ibid.*) Pursuant to the California Water Resources Act (Stats. 1945, ch. 1414, p. 2827), the counties of Santa Clara, Santa Cruz, San Benito, and Monterey entered into agreements with USACE accepting responsibility for the maintenance and operations of the Project. (*Arreola, supra*, at p. 732.) The Legislature soon thereafter created MCWRA's predecessor agency. (*Ibid.*; Stats. 1947, ch. 699, §§ 2, 4, p. 1739.) MCWRA was created in 1990 and succeeded to the prior agency's responsibilities for maintaining and operating the Project. (*Arreola, supra*, at p. 732; Stats. 1990, ch. 1159, p. 4831.) In 1947, MCWRA's predecessor and the three other counties signed a resolution providing the necessary assurances required by the federal government. (*Arreola, supra*, at p. 732.) Two months later, the four county governments, including Monterey County, executed an indemnity agreement among themselves assuming responsibility for the Project's maintenance and operations within each county's respective boarders. (*Arreola, supra*, at p. 763.)

For twenty years prior to the flooding that occurred in 1995, the defendant entities allowed the river to fill with vegetation and sediment, reducing the capacity of the Project. (*Id.* at p. 732–735.) Although well within the original design capacity of the Project, the long-term neglect meant that the channel capacity was significantly less than designed, and the increased flows overtopped the levee. (*Id.* at p. 736.)

One of the chief issues raised on appeal was that all the entities should not be liable for inverse condemnation. The Court of Appeal gave significant attention to the issue, ultimately determining that public entities may be liable in inverse condemnation where the design, construction, or maintenance of a flood control project poses an unreasonable risk of harm to the plaintiff's property, and the unreasonable aspect of the improvement is a substantial cause of damage. (*Arreola, supra*, at p.740 (applying *Locklin v. City of Lafayette* (1994) 7 Cal.4th 327, 350.) The court concluded that the counties could be liable under the *Locklin* factors and that the failure to maintain the Project were deliberate policies of the counties: "the 'plan' was the long-term failure to mitigate a known danger. That failure persisted for 20 years." (*Arreola, supra*, at p. 746.)

More relevant here, the Court of Appeal then addressed the County of Monterey's separate argument that it could not be liable because it did not have any responsibility for the Project. (*Id.* at p. 761.)

The County argued that the trial court incorrectly held that it was liable on a theory of vicarious liability because the MCWRA was a separate legal entity. (*Arreola, supra*, at p.761.) The Court of Appeal rejected this argument: the liability was not vicarious and the judgment was based on the County's own direct liability because the County substantially participated in the Project. (*Ibid.*) The court first explained that a public entity is the proper party in an inverse condemnation proceeding where "the entity substantially participated in the planning, approval, construction, or operation of a public project or improvement that proximately caused injury to private property." (*Id.* at pp. 761, citing *Wildensten v. East Bay Regional Park Dist.* (1991) 231 Cal.App.3d 976–980).) "So long as the plaintiffs can show substantial participation, **it is immaterial 'which sovereign holds title or has the responsibility for operation of the project**.'" (*Arreola, supra*, p. 761, quoting *Stoney Creek Orchards v. State of California* (1970) 12 Cal.App.3 903, 907, emphasis added.) Importantly, substantial participation could occur in circumstances where participation was not active. (*Id.* at p. 762.) This included approving a permit for a drainage plan. (*Ibid.*; citing *Frustuck v. City of Fairfax* (1963) 212 Cal.App.2d 345.) Substantial participation could also include a deliberate failure to maintain pipes where the pipes eventually burst and caused flooding. (*Arreola, supra*, p. 762, citing *McMahan's of Santa Monica v. City of Santa Monica* (1970) 7 Cal.App.3d 826, 832.) Liability based on substantial responsibility requires that the public agency have the ability to control (thus prevent) the particular aspect of the improvement at issue. (*Arreola, supra*, p. 762, citing *Low v. City of Sacramento* (1970) 7 Cal.App.3d 826, 832.)

The court thus articulated the following rule:

> [A] public entity is a proper defendant in a claim for inverse condemnation if it has the power to control or direct the aspect of the public improvement that is alleged to have caused the injury. The basis for liability in such a case is that in the exercise of its governmental power the entity either failed to appreciate the probability that the project would result in some damage to private property, or that it took the calculated risk that the damage would result. [Citation.]

(*Arreola, supra*, pp. 762–763.)

The court then applied the rule to the case before it. First, by signing the initial indemnity agreement between itself and the other three counties, the County gave assurances to the federal government that it was assuming responsibility for the improvement. (*Arreola, supra*, at p. 763.) Then, the County further exercised financial control over MCWRA. (*Ibid.*) The County and MCWRA shared the same board members and boundaries, and the employees of the County were ex officio employees of MCWRA who performed duties for both entities. (*Ibid.*) Although

common board members alone would not necessarily establish county control, it was relevant to the inquiry. (*Id.* at pp. 763–764.) Particularly significant was the financial connection between the entities. (*Id.* at p. 764.) MCRWA had no independent funding sources sufficient for its obligations, and the maintenance failure from which liability arose came from a funding shortfall created by the County's failure to fund maintenance. (*Ibid.*) There was no factual question that the County was aware of the longstanding maintenance issues, and its failure to fund the maintenance of the levees constituted substantial responsibility. (*Ibid.*)

The final part of the court's analysis involved the broader public policy concerns. The County argued that it had no obligation to fund MCRWA or maintain the levee. (*Arreola*, *supra*, at p. 765.) The court rejected that argument, comparing it to a similar case before the California Supreme Court, *Shea v. City of San Bernardino* (1936) 7 Cal.2d 688 (*Shea*). In *Shea*, the defendant city argued that it had no power to fix a dangerous condition that existed on a railroad right of way because the right of way was under the exclusive jurisdiction of the state Railroad Commission. The court rejected this argument, holding that "the improvement of streets within the boundaries of a city is an affair in which the city is vitally interested. The governing board and officers of the municipality in dealing with such an affair may not complacently declare that they were powerless over a long period of years to take any reasonable steps to remedy a defective and dangerous condition that existed in one of the principal streets of the city." (*Id.* at p. 693.) The court in *Arreola* noted that the *Shea* only involved a personal injury. The policy concern raised in *Shea* "applies with even greater force where the risk threatens an injury such as that which occurred here." (*Arreola*, *supra*, at p. 765.)

The breadth of the City's potential inverse condemnation liability for inverse condemnation is somewhat circumscribed by *Tilton v. Reclamation Dist. 800* (2006) 142 Cal.App.4th 848. In *Tilton*, the defendant was a reclamation district tasked with maintenance and operations of a levee. (*Id.* at p. 851.) The trial court sustained the district's demurrer to the complaint for damages by a landowner alleging that improper maintenance work on a levee resulted in property damage. (*Id.* at p. 852.) The Sixth District Court of Appeal upheld the demurrer, holding that merely undertaking maintenance and operation of an existing levee does not necessarily give rise to an inverse condemnation claim where mere garden-variety inadequate maintenance is alleged. (*Id.* at p. 859.) The court distinguished the case at issue, where the defendant district was "charged merely with routine maintenance of a levee," from circumstances where "a defendant designed, constructed *and* was thereafter charged with implementing a plan for its maintenance." (*Id.* at p. 857.) In making this point, the court relies on *Arreola*, where the entities made a "deliberate act to undertake a particular plan or manner of maintenance." (*Ibid.*)

At first blush, *Tilton* appears to support the City's argument that mere maintenance and operations cannot give rise to inverse condemnation liability and that it is protected from liability "unless the City entered into new obligations or increased its own role in project related activities after the reorganization." (City of West Sacramento Agenda Report (May 23, 2018), p. 3.) But such a conclusion misapplies both *Tilton* and *Arreola*.

In *Arreola*, the "'plan' was the long-term failure to mitigate a known danger. That failure persisted for 20 years." (*Arreola, supra*, at p. 746.) Accordingly, the County of Monterey's continued failure to fund maintenance despite knowledge of the attendant dangers itself constituted a plan sufficient for liability to arise. The maintenance at issue in *Tilton* involved the quality of specific maintenance work; it did not relate to issues with whether and how maintenance should occur on a broader scale or timeline. (*Tilton, supra*, at p. 852.) If the City is relying on *Tilton* for its conclusion that it is safe from inverse condemnation liability, it is misapprehending both *Tilton* and *Arreola*. *Tilton*'s application is limited to particular circumstances of negligent maintenance, and does not stand for the broader proposition that the successor agency could incur liability for inadequate maintenance that constitutes a long-term failure to mitigate a known danger.

Applied here, *Arreola* indicates that the City could be exposed to liability for inverse condemnation if faced with similar facts as the County of Monterey. We believe that the City has not signed a similar indemnification agreement as the County of Monterey did in 1947. Although that fact distinguishes the particular circumstances here from *Arreola*, it does not appear to be dispositive. Like in *Arreola*, the boards for both City and the subsidiary agency would be the same. The City's proposal would likely give it complete financial control over the consolidated subsidiary agency in the same manner that MCRWA relied on the County for funding its operations. The RDs already have assessments and funding sources that would not require Proposition 218 approval by a successor agency. (Yolo LAFCo Report, p. 7.) If a merger occurs, there would be risk that the City might seek to use funds previously dedicated solely for flood protection to multipurpose projects, such as the maintenance of City recreation facilities located on and adjacent to levees. (*Ibid.*) Such funds would be insulated by a subsidiary structure (*ibid.*), but this only contemplates existing funding needs, not prospective maintenance requirements that might arise. *Arreola*'s conclusion appears to rest much more on the County's total financial control of MCRWA, knowledge of the problems, and subsequent failure to act. (*Arreola, supra*, p. 764.) Obviously, the City could take steps to continue to insulate itself, but the risk is that over time the initial separation bleeds away.

The City's report states that liability for inverse condemnation would only arise if the City entered into new obligations or increased its own role in the project after reorganization. (City Agenda Report, p. 3.) But under *Arreola*, the City could be found substantially responsible if it is shown that a levee failure resulted from the City's failure to fund the maintenance of the levees with knowledge that the maintenance was necessary to the continued safe operation of the levees.

With the RDs being subsidiary districts of the City governed by the City Council, the directors of the West Sacramento Area Flood Control Agency ("WSAFCA") would all three then be City Council Members. There are significant portions of levee still to be reconstructed or modified over the next several years to meet flood protection goals. Thus, with WSAFCA being responsible for levee improvements, City Council Members would not only be making levee operation and maintenance decisions as the governing body for the RDs, but would also be selecting consultants for levee improvement design, approving such design, and selecting

contractors and performing construction management on levee improvements as directors of WSAFCA. Thus, the West Sacramento City Council will have complete direction and control over not only operation and maintenance of existing and newly resconstructed levees, but also over funding, design and construction of levee improvements.

The City's position ignores the possibility that new maintenance issues could arise or new circumstances can increase the current burden for maintaining and operating the levee. Such was exactly the case in *Arreola*. For the first few decades of the Project's operations, the responsible agencies economically maintained the capacity of the Project by using heavy equipment to regularly remove vegetation and sediment buildup. (*Arreola*, *supra*, at p. 733.) But environmental stakeholders, including the then-Department of Fish and Game, curtailed the use of heavy equipment. (*Id.* at pp. 733–734.) As the riparian ecology grew, the environmental stakeholders' ability to stymie maintenance efforts increased and the agencies' ability to economically remove channel obstructions diminished. (*Id.* at p. 734.) Starting in the 1970s, the increased cost and complexity of maintaining the channel resulted in paralysis. (*Id.* at pp. 734–735.) By 1995, the vegetation and sediment significantly reduced the channel's capacity. (*Id.* at p. 735.)

If the City is faced with such an issue, it could be liable for inverse condemnation because of *inaction* on known problems. It is not impossible to imagine a scenario in which voters decline to increase a district assessment for operation and maintenance, leaving the City with the Hobson's choice of whether to fund maintenance (with the risk of liability) or to not fund maintenance (with the risk of liability). Given the City's competing financial demands and obligations and the uncertainty posed by third parties, it is entirely possible for circumstances to arise where levee maintenance becomes insufficient and the City, by virtue of its financial control, becomes substantially responsible for any failures resulting from the insufficient maintenance.

Arreola does not create per se liability for the City for inverse condemnation in the event of a levee failure. However, it is disingenuous for the City to assert that it can simply avoid such liability unless it "entered into new obligations or increased its own role in project related activities after the reorganization." As *Arreola* explains, inaction alone is certainly a pathway to significant liability for the City despite the proposed subsidiary district's separate legal existence.

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June 7, 2019

VIA ELECTRONIC MAIL

Jeffrey Mitchell
West Sacramento City Attorney
400 Capitol Mall, 27th Floor
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jmitchell@kmtg.com

RE: Follow-Up on Legal Opinion re: Application Nos. 925, 926 & 930

Dear Jeffrey:

I write to invite the City of West Sacramento ("City") to respond to an issue raised in Reclamation Districts 537 and 900 ("RDs") memorandum to the Yolo Local Agency Formation Commission ("LAFCo") regarding the City of West Sacramento's liability after creation of subsidiary districts pursuant to the City's application to LAFCo.

Opponents of the City's proposal raised the concern that the City would be assuming an unknown amount of liability by taking over operation of the RDs' levees.[1] The City and RDs' memos agree that the City would not assume the RDs' liabilities if they became subsidiary districts merely by virtue of their shared boards.[2] However, the RDs go on to discuss the potential for the City to be held directly liable for its substantial participation in flood-prevention activities. The RDs argue that the City's close connection with the subsidiary districts could increase the chance the City would face liability as the City became more involved in flood control after LAFCo approved the City's proposal.

Because the issue of enhanced direct liability was not squarely discussed in the City's memo, LAFCo would benefit from learning the City's position regarding the RDs' argument. Inverse condemnation liability may attach to a

[1] *See* Sacramento Bee, *Could West Sacramento be forced to pay up if the river floods. Mayor and residents disagree* (June 18, 2018), *available at* https://www.sacbee.com/news/local/article213303629.html ("Chief among residents' concerns is that the city could possibly be liable for flood damages if levees were to break.").

[2] The City's memorandum concludes that "the City would not be liable for any action or inaction of the RD even if the City Council was also the governing board for the RD unless an independent basis existed for holding the City liable." *See* City Memo at 4. Similarly, the RDs state that "the City is unlikely to be liable for the conduct of the consolidated subsidiary district absent facts supporting direct liability…." *See* RDs' Memo at 2.

public entity "if the entity substantially participated in the planning, approval, construction, or operation of a public project or improvement that proximately cause injury to the private property." *Arreola v. County of Monterey*, 99 Cal. App. 4th 722, 761 (2002). What constitutes "public participation" can vary from case to case. Experience shows that plaintiffs following a significant flood event will seek to recover damages from any agency that is even tangentially involved in flood control activities. It is therefore possible that the City already has some "power to control or direct" certain flood-control activities that could expose it to liability.

The RDs raise the point that making the RDs into subsidiary districts could provide the City with additional power over the subsidiary districts and their flood control infrastructure and activities, possibly increasing the exposure to liability. The RDs argue that the City's control would increase over time, and the distinction between the City and its subsidiary districts would diminish. This may or may not come true, because maintaining the distinct nature of its subsidiary districts would largely be left to the City, which would be in the best position to balance operational considerations with the risk of liability and could take measures to allocate those risks.

Given that the question of liability has been one of the focal points of the City's application, we invite the City to respond to the RDs' memo on the question of whether establishing subsidiary districts might increase the likelihood of direct liability for the City. In addition, we invite the City to describe what steps (e.g. financial, staffing, etc.) it plans to take as part of its plan for services to segregate liability within the subsidiary districts without exposing the City to direct liability.

I ask that the City provide its response, if any, by June 21, 2019, to allow LAFCo staff sufficient time to analyze the issue. As before, the submission is completely voluntarily, and the City will not be penalized if it elects not to respond to this request. Please also note that anything submitted will be included with the City and RDs' memos in the public record.[3]

Please contact me directly if you have any questions or if I can offer any clarification.

Sincerely,

Eric May
Yolo LAFCo Commission Counsel

CC: Christine Crawford (Christine.Crawford@yolocounty.org)
James Day, Jr. (jday@daycartermurphy.com)

[3] I am not sending a similar request to the RDs because I felt that their memorandum addressed the issue of direct liability and I wanted to give the City an opportunity to respond. Of course, nothing herein precludes the RDs from providing additional analysis on the issue if they wish to submit it for LAFCo's consideration. I just ask that it be provided by June 21, 2019, as well.

CITY OF WEST SACRAMENTO

July 3, 2019

Christine Crawford, Executive Director
Yolo LAFCo
625 Court Street, Suite 203
Woodland, CA 95695

RE: Responses to Questions raised in LAFCo's June 7, 2019 Letter re Application Nos. 925, 926 & 930

Dear Ms. Crawford:

The Yolo LAFCo has before it the City of West Sacramento's ("City") proposal to reorganize Reclamation District 900 ("RD 900") and a portion of Reclamation District 537 ("RD 537") located within the City's boundaries. Under this proposal, the RDs would become subsidiary districts of the City with the City Council serving as the governing board. However, the RDs, either singularly or as consolidated as one entity, would retain a separate legal identity and existence. Prior to consideration of the City's proposal, and at LAFCo's request, both the City and RD 900 submitted memoranda to LAFCo on February 28, 2019, addressing numerous issues related to the City's proposal.

In a letter dated June 7, 2019, LAFCo has now asked the City to: (1) Respond to the RD's memo on the question of whether establishing a subsidiary district might increase the likelihood of direct liability for the City; and (2) Describe what steps (i.e. financial, staffing, etc.) the City plans to take as part of its plan for services to segregate liability within the subsidiary districts without exposing the City to direct liability. The City, therefore, offers the following response to LAFCo explaining how its proposal is not likely to increase the likelihood of direct liability for the City, and the steps the City intends to take to reduce any potential for direct liability.

The City's Proposal Will Not Increase The Likelihood Of Direct Liability

In its February 28, 2019 submission to LAFCo, the City responded to various questions raised by LAFCo including: "How would creation of RD 900 and RD 537 as subsidiary districts to the City affect the City's exposure to liability in the event of a flood event?" As reiterated by the City, under its proposal "the RDs would not merge with and be subsumed by the City. Instead, they would retain independent existence as subsidiary agencies. The only change would be that the City Council would constitute the RDs governing board rather than having an independently elected or appointed board." RD 900's February 28, 2019 submission to LAFCo similarly concluded: "it is unlikely that a court would apply a theory of vicarious liability or some form of 'piercing the corporate' veil in this context. Instead, the City is unlikely to be liable for the conduct of the consolidated subsidiary district absent facts supporting direct liability . . .." LAFCo's June 7, 2019 letter appropriately concludes that: "The City and RDs' memos agree that the City would not assume the RDs' liabilities if they become subsidiary districts merely by virtue of their shared boards."

Even if no basis would exist for vicarious liability, the RD 900 memorandum suggests the City might still be liable for inverse condemnation flood damages under a direct liability theory. As summarized by LAFCo's June 7, 2019 letter, "The RDs argue that the City's close connection with the subsidiary districts could increase the chance the City would face liability as the City became more involved in flood control after LAFCo approved the City 's proposal." In light of this assertion, LAFCo has requested the City to address the issue of the City's alleged "enhanced direct liability" as noted in RD 900's memorandum.

In making its argument, RD 900 primarily relies upon the case of *Arreola v. County of Monterey* (2002) 99 Cal.App.4th 722. The *Arreola* case involved efforts to hold the State, the Monterey County Water Resource Agency ("MCWRA"), the County of Monterey ("County") and other entities liable for inverse condemnation damages due to flooding after the failure of the Pajaro River Levee Project. (*Id.* at 730.) The MCWRA is a distinct legal entity, but the County Board of Supervisors serves as its governing body. (*Id.* at 732, 763.) In *Arreola*, the County argued that, since the MCWRA was a separate legal entity, the County could not be derivatively liable for the MCWRA's "inadequate maintenance of the project." (*Id.* at 761.) However, the Court determined that the County was directly and not derivatively liable. (*Ibid.*)

In making this determination, the Court noted the fact that the County and MCWRA shared the same board of directors was relevant, but the Court also listed several other significant factors showing the financial connection between the two entities which supported the County's direct liability. (*Id.* at 764-766.) Specifically, the County had expressly entered into its own indemnity agreement with federal authorities, and as the Court explained "[t]he plain language of this agreement supports the conclusion that Monterey assumed responsibility for the Project's operation and maintenance."[1] (*Id.* at 763.) As described below, the City is not a party to any comparable agreement.

Additionally, the County had financial control over the MCWRA and exercised control over the project through this financial control. (*Id.* at 763) The County's "financial statements report MCWRA financial activity as if MCWRA was a part of the County. The statements expressly state that they do not report the financial activity of those agencies over which Monterey cannot impose its will or with which Monterey does not share a financial benefit, burden relationship. By implication, the inclusion of MCWRA on Monterey's financial statement means that Monterey itself considers that it is able to impose its will on MCWRA . . .." (*Id.* at 764.) The Court further stressed the dependency of the MCWRA on the County for direct financial support noting that the MCWRA

"never had a revenue source, independent of the county's financial resources, that was sufficient to fulfill its promise to operate and maintain the Project" and "the only way MCWRA could have afforded to undertake the needed maintenance of the Project was to depend upon assistance from the county." (*Id.* at 764.) By contrast, the RDs have their own sources of funding to support levee maintenance. Finally, the Court noted that County employees were considered ex officio employees of the MCWRA and were required to perform the same duties for both. (*Id.* at 763.) These multiple factors beyond simply a shared governing board led the Court to find direct liability appropriate since the County "substantially participated in the planning, approval, construction, or operation of a public project or improvement that proximately caused injury to private property" and it had "the power to control or direct the aspect of the public improvement that is alleged to have caused the injury." (*Id.* at 761, 762.)

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[1] According to the indemnity agreement, "each County assumes to itself the sole obligation and responsibility occasioned by the adoption of the resolution marked Exhibit 'A,' for that portion of the project which is to be constructed within it's [sic] boundaries and being bound to each other County to hold them and each of them harmless and free from any liability or obligation arising by reason of the adoption of the resolution marked Exhibit 'A' as to that portion of said project within it's [sic] own boundaries; meaning that each County will take care of the assurances given and obligations incurred by reason of the resolution marked Exhibit 'A' insofar as they relate to that part of the project being constructed within it's [sic] boundaries." (*Id.* at 763.)

RD 900 places prime reliance on the fact "the boards for both City and the subsidiary agency would be the same" and then concludes that the City would likely have "complete financial control over the consolidated subsidiary agency . . .." However, unlike in *Arreola*, there is no indemnity agreement nor any other documentation indicating the City could simply impose its will on the RDs or that the City assumed responsibility for the project's operation and maintenance. RD 900 also acknowledges that: "[t]he RDs already have assessments and funding sources . . .." RD 900 simply speculates that "the City might seek to use funds previously dedicated solely for flood protection to multipurpose projects" or that there is "risk that over time the initial separation bleeds away." RD 900 also simply speculates that, as a result of changed conditions over time, "new maintenance issues could arise or new circumstances can increase the current burden for maintaining and operating the levee." This is simply unfounded speculation. Likewise, statutes, court decisions and actions by third parties could also potentially impact a public entity's liability for flooding or any other condition or occurrence, but in moving forward the parties must necessarily deal with present and readily anticipated future facts and not upon what might, or might not, occur at some unknown future date due to some unknown conjectured set of facts.

Additionally, in noting a municipality's potential general obligation as to conditions within its boundaries, the Court in *Arreola* quoted the case of *Shea v. City of San Bernardino* (1936) 7 Cal.2d 688 wherein the Court noted: "the improvement of streets within the boundaries of a city is an affair in which the city is vitally interested. The governing board and officers of the municipality in dealing with such an affair may not complacently declare that they were powerless over a long period of years to take any steps to remedy a defective and dangerous condition that existed in one of the principal streets of the City." (*Id.* at 765.) Even assuming such a principle of general municipal liability were applicable to the levees, which the City does not concede, the reorganization of the RDs into subsidiary districts would not alter any such existing general municipal liability. Thus, notwithstanding its attempt to find some basis for future liability, RD 900 essentially argues that simply because the City and the RDs would share a common governing board the City might possibly incur increased liability depending upon some unknown set of future facts. This argument must rely upon principles of vicarious liability holding the City liable solely upon the common governing board. However, even RD 900 admits a court would be unlikely to rely upon such a theory of vicarious liability.

In its memorandum, RD 900 does acknowledge that "[t]he breadth of the City's potential inverse condemnation liability for inverse condemnation is somewhat circumscribed by *Tilton v. Reclamation District 800* (2006) 142 Cal.App.4th 848" wherein the court held "merely undertaking maintenance and operation of an existing levee does not necessarily give rise to an inverse condemnation claim where mere garden variety inadequate maintenance is alleged." This is consistent with prior decisions. For example, a public entity which is responsible just for ordinary maintenance and which could not alter the structure of the levee would not share in liability resulting from the failure. (*Paterno v. State of California* (2003) 113 Cal.App.4th 998, 1004.) Additionally, an entity cannot be faulted for failing to upgrade an existing system. (*Id.* at 1031.) RD 900 notes that *Tilton* "does not stand for the broader proposition that the successor agency could [not] incur liability for inadequate maintenance that constitutes a long-term failure to mitigate a known danger." However, under the City's proposal, it would not be a "successor agency" but the RDs would continue in existence as independent entities. Additionally, the City would not assume operation and control of the levees, but such responsibilities would remain with the RDs . The sharing of a common board would not alter these roles. That the City might engage in maintenance activities related to the levees would not, but itself, provide a basis for increased liability.

Under the City 's proposal, the RDs would remain in existence, and the City would not necessarily take on any additional responsibilities or obligations as to the levees, There is no existing indemnity agreement whereby the City is committed to operate and control the levees or financially support the RDs. The RDs have, and will continue to have, their own financial resources which the RD will control. As discussed below, the City also anticipates structuring RDs staffing and financing in a manner that will retain the separate status. Unfounded conjecture and speculation should not undercut these known facts. Instead, the better presumption is that the City will comply with its legal obligations. (*See, e.g., Richardson v. Department of Motor*

Vehicles (2018) 25 Cal.App.5th 102, 113 ["We must presume, in the absence of contrary evidence, that a public agency follows its official duties as prescribed by the applicable statutory law."].) Based upon this principle and the known facts, no basis exists for concluding the City would face increased liability simply if RD 900 or RD 537 becomes subsidiary districts.

City Council's Plans Upon The RDs Becoming Subsidiary Districts

Mindful of the legal landscape described above, the City is committed to maintaining the Reclamation Districts as financially strong, operationally distinct legal entities from the City. As noted elsewhere, under the "subsidiary district" structure contemplated by Cortese-Knox-Hertzberg (and recommended by LAFCo staff), the City Council will assume governance of the RDs as the "*ex-officio*" District Boards. The Reclamation Districts would, however, continue in existence with all of the powers, rights, duties, obligations, and functions provided for by the principal Reclamation District Act. The only substantive change would be to replace an opaque governance structure that neither solicits nor welcomes public oversight with a structure that is transparent and responsive.

The City Council, as the governing board of the RDs, would approve organizational and staffing decisions for the RDs, but as legally separate entities from the City, the RDs would be supported by legally separate staffing. To the extent the City Council determines that staffing services for the RDs are most appropriately provided by the City (for example by providing administrative and accounting services), a written contract for "shared services" between the City and RDs, similar to other shared services agreements like the one the City has used with the Port of West Sacramento and the City of Winters, would be required. Under this structure, the City Council, acting as the governing board of the RDs, would approve the budgets for the RDs and make decisions governing levee maintenance and operations of the RDs as separate legal entities. Levee improvement decisions will continue to be decided by West Sacramento Area Flood Control Agency, which was formed as a Joint Powers Authority and is a separate and distinct entity from the City and the individual RDs with their own governing body dictated by the JPA formation documents.

From a financial standpoint, the simple virtue of having the City Council also serve as the governing board for the RDs would create "financial accountability" under GASB 14 and 61,even though the City would not take over any financial obligations of the RDs. In this case, there is no financial dependency or burden created for the primary government (City) as a result of this relationship, but the City would be required to report the financial status of the RDs as component units in the City's financial statements. If the City were to track and report the financial transactions and status of the RDs, the City would be required to maintain separate Funds for the Component Units, tracking the RDs' revenues, expenditures, assets and obligations separate from City transactions, assets and obligations.

To summarize, the RDs and their separate staff and financial reporting structure will continue to operate organizationally as they have to date with the RDs governing board subsequently being made up of members of the City Council.

The City appreciates the opportunity to address LAFCo's questions and concerns. Please contact me if you require any additional information.

Sincerely,

Aaron Laurel
City Manager

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July 11, 2019

Christine Crawford, Executive Director
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Re: *City of West Sacramento July 3, 2019 Response to Yolo LAFCO June 7, 2019 Follow-Up on Legal Opinion Re: Application Numbers 925, 926 & 930*

Dear Ms. Crawford and Mr. May:

This is just a brief response to the City's July 3, 2019 letter referenced above.

Subsidiary Districts are not Independent entities:

At least twice in the City of West Sacramento's ("City") July 3, 2019 response it is stated that the RDs, if made subsidiary districts to the City would retain their "independent" existence or would not be a "successor agency" but would continue in existence as "independent entities". Subsidiary districts are not, by definition, "independent". That is why they are called "subsidiary" districts.

The City will have financial control:

In its July 3, 2019 response the City stated that, "The RDs have, and will continue to have, their own financial resources which the RDs will control". In fact, the RD 900's assessment under the 1982 Benefit Assessment Act may be utilized only for operation and maintenance of internal drainage systems. Levee operation and maintenance by RD 900 is funded entirely by a transfer to RD 900 by the West Sacramento Area Flood Control Agency ("WSAFCA") under its assessment. WSAFCA also provides an allocation of its assessment to RD 537 for levee operation and maintenance, and a portion of RD 537's operation and maintenance assessment is used for levees.

Control of the funds allocated for levee operation and maintenance to the RDs by WSAFCA lies solely with WSAFCA's governing board which, if the RDs are made subsidiary districts to the City, will be governed by members of the City Council. Thus, in addition to having the ability to levy annual assessments made directly by the RDs, the City will, in addition, control funds allocated by WSAFCA for levee operation and maintenance by the RDs.

The City will have substantial participation in the planning, approval and construction of some levee rehabilitation projects:

Through the City Council serving as the governing board of the RDs the City will not be "merely undertaking maintenance and operation of an existing levee (as the City quotes from *Tilton v. Reclamation District 800* (2006) 142 Cal. App. 4th 848) but will have significant control over all aspects of levee rehabilitation projects undertaken by WSAFCA, as City Council members will be the WSAFCA governing board members.

WSAFCA has taken the lead in several levee rehabilitation projects in advance of Congressional appropriations to enable the United States Army Corps of Engineers ("USACE") to take the project lead, and will continue to do so until such an appropriation is made by Congress. A design funding agreement has been entered into by WSAFCA along with the California Department of Water Resources and the USACE for design of additional projects which would be undertaken by WSAFCA, with credit given toward the required local share once an adequate Congressional appropriation has been made.

Thus, the City, through City Council members serving as the governing board of WSAFCA, will be selecting design engineers, approving design, selecting construction contractors, supervising construction or selecting construction management firms to do so, and accepting completion of future levee rehabilitation projects. If this is not substantial participation in the planning, approval or construction of a public project or improvement that may proximately cause injury to private property within the meaning of *Arreola v. County of Monterey*, 99 Cal. App. 4th 722, 761 (2002), we don't know what is.

The Central Valley Flood Protection Board may very well require that the City sign an assurance agreement for levee operation, maintenance, repair, rehabilitation and replacement:

Finally, it is entirely possible, and we believe likely, that the Central Valley Flood Protection Board, especially if the City portion of RD 537 is merged into RD 900 and 900 then made a subsidiary district of the City, would require that the City enter into an assurance agreement with the Board committing to operation and maintenance of the system in perpetuity (see the Central Valley Flood Protection Board letter of February 28, 2019 to Christine Crawford).

Yours very truly,

DAY CARTER & MURPHY LLP

James M. Day, Jr.

JMD:tl
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